



A U D I T O R - G E N E R A L

REFERENCE: 21298REG07/08  
ENQUIRIES: S HLATSHWAYO  
DATE: 15 DECEMBER 2008

The Municipal Manager  
O R Tambo District Municipality  
Nelson Mandela Drive  
**MTHATHA**  
5100

Dear Sir

**O R TAMBO DISTRICT MUNICIPALITY: AUDIT REPORT FOR THE FINANCIAL YEAR ENDED  
30 JUNE 2008**

A copy of the report issued to the Mayor is forwarded, herewith, for your information.

Yours faithfully

**S Hlatshwayo**

*for* **AUDITOR-GENERAL  
East London**

# **REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF O.R. TAMBO DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008**

## **Introduction**

1. I was engaged to audit the accompanying financial statements of the O.R. Tambo District Municipality ("the municipality") which comprise the statement of financial position as at 30 June 2008, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

## **Responsibility of the accounting officer for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) ("MFMA") and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). This responsibility includes:
  - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

## **Responsibility of the Auditor-General**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004), my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and General Notice 616 of 2008, issued in Government Gazette No. 31057 of 15 May 2008. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
4. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the O.R. Tambo District Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.

## **Basis of accounting**

5. The municipality's policy is to prepare financial statements on a comprehensive basis accounting as determined by the National Treasury, as set out in accounting policy note 1 of the annual financial statements.

## **Basis for disclaimer of opinion**

### **Revenue – Service charges**

6. The revenue accounting system does not include all residents in the municipal district that receive water services. Revenue from the water usage of these residents is therefore not recorded. Also, adequate water metering systems have not been implemented in some local municipalities for the recording of water consumption and the remaining local municipalities have been excluded from the revenue base. Some water meters were found to be damaged or were not accessible and revenue for water services to these consumers has not been recorded or billed. Locations were identified where meters were either not installed or meter readings were not taken even though water services were provided. The revenue accounting system does not include residential or postal addresses for all consumers. As a result it cannot be confirmed whether these consumers receive statements of account. In addition, a calculation of distribution losses incurred during the year was not performed.
7. The municipality's records and systems did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness of service charge revenue amounting to R57.2 million, as disclosed in note 17 to the annual financial statements.

### **Government grants and subsidies**

8. In terms of the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA), an amount of R565,8 million should have been received during the year. Due to releases in the current year of R56,4 million relating to prior year amounts that were withheld, an amount of R622,2 million should have been received. Appendix G reflects that an amount of R647,8 million was received. An adequate explanation of the difference of R25,6 million was not provided. Current year receipts of R443 million, as disclosed in Appendix G were not reconciled to the receipts of R445 million disclosed in Appendix F to the annual financial statements, either individually or in total.
9. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness and accuracy of government grants and subsidies revenue as disclosed in the statement of financial performance.
10. Furthermore, no supporting documentation for the equitable share allocated to subsidise the provision of basic services to indigent consumers, along with the monthly subsidies as disclosed in note 18 to the annual financial statements, was submitted for audit purposes.

### **Expenditure**

11. I was unable to obtain sufficient appropriate audit evidence to support journal entries relating to the reallocation of contract expenditure from unspent conditional grants amounting to R9.9 million. Also an adjustment of R7.4 million was made to general expenditure when the municipality effected audit adjustments to the annual financial statements and no supporting documentation was submitted for these changes. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the occurrence and

accuracy of general expenditure amounting to R640.5 million as reported in the statement of financial performance.

12. Documentation supporting quarterly expenses disclosed alongside quarterly receipts on Appendix F to the annual financial statements was also not submitted.

### **Funds and reserves**

13. I was unable to verify the opening balance of the accumulated surplus due to the disclaimer of audit opinion issued in the prior year. Misstatements which were identified in the prior year have not been corrected and as a result I was unable to satisfy myself as to valuation of the accumulated surplus of R56.1 million as reported in the statement of financial position and changes in net assets.

### **Provisions**

14. The provision for leave of R14.2 million disclosed in note 3 to the annual financial statements is based on the leave records of the municipality, which were found to be inadequate. Instances were found where leave recorded as taken was not supported by leave applications and documentation authorising the absence from work. Attendance registers for some employees were not submitted. The municipality's records and systems did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the accuracy and valuation of the provision for leave of R14.2 million as disclosed in note 3 to the financial statements.

### **Unspent conditional grants**

15. A reconciliation between the unspent conditional grant liability of R132 million and related bank balances amounting to R87.7 million was not submitted. An adequate explanation for the shortfall of R44.3 million could not be provided. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness, existence and valuation of the unspent conditional grant liability of R132 million as disclosed in note 4 to the annual financial statements.

### **Property, plant and equipment**

16. The fixed asset register did not contain sufficient information describing the assets to enable verification of the existence of the assets
17. The municipality's assets records and systems did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the valuation, accuracy, existence, completeness and rights pertaining to ownership of assets of the municipality to the value of R114.1 million as disclosed in the statement of financial position.
18. Appendix E to the annual financial statements discloses a comparison between budgeted and actual capital expenditure. Budgeted capital expenditure is not correctly disclosed, as actual additions of R72.1 million are disclosed instead of budgeted figures.
19. GAMAP 17.15 states that it is appropriate to allocate the total expenditure on an asset to its component parts and account for each component separately when the component assets have different useful lives or provide benefits to the entity in a different pattern, thus necessitating the use of different depreciation rates and methods.

The municipality does not separate its fixed assets in terms of their individual components. Thus GAMAP 17 was not complied with.

20. Accounting policy note 5 states that property, plant and equipment is stated at cost, less accumulated depreciation, except land and buildings, which are revalued. The municipality has not revalued its land and buildings. Therefore the accounting policies have not been followed correctly.

### **Biological assets**

21. IAS 41 (Agriculture) requires full disclosure of biological assets owned by the municipality. This includes non-financial measures or estimates of physical quantities of output during the period and assets on hand at the end of the period, financial risk management strategies and methods and assumptions for determining fair value. This information is not disclosed in note 8 to the annual financial statements. Thus IAS 41 was not complied with.

### **Water inventory**

22. The municipality only took into account the water inventory for the Mthatha area of the district. Therefore the chemicals used to treat water in the storage reservoirs, dams, treatment works and water pipes in the other areas within the district has not been accounted for. As a result, I was unable to verify the completeness and valuation of water inventory of R8.5 million as reported in the statement of financial position.

### **Consumer debtors**

23. The municipality could not submit documentation and explanations in support of indigent debtor applications, approvals and monitoring that was requested. In addition the value of indigent debtors was not separately identifiable. As a result I was unable to determine whether the subsidies awarded to indigent debtors were complete and accurate.
24. The municipality's records and systems did not permit the application of alternative audit procedures to confirm the existence, completeness and valuation of debtors. Consequently, I was unable to satisfy myself as to the existence, completeness and valuation of consumer debtors of R55 million as reported in the statement of financial position.
25. The policy of the municipality is to provide for doubtful debts. However, this policy was found to be deficient. As a result, the provision for doubtful debts of R57.8 million as disclosed in note 14 to the annual financial statements was found to be inadequate. In addition, the municipality does not have any consumer deposits on hand to cover outstanding amounts from debtors, does not charge interest and penalties on overdue balances, and does not hand over long-outstanding balances to debt collecting agents. The amount recovered in the month following year-end was used as a basis for the estimate of the recoverability of accounts receivable. Therefore the provision for doubtful debts is understated by an estimated amount of R50.5 million, and the consumer debtors is overstated by an estimated amount of R50.5 million.

## **Value Added Taxation (VAT)**

26. VAT due from SARS of R19.4 million is disclosed in note 5 to the financial statements. These balances have not been reconciled to the VAT 201 returns, and as a result no documentation is available to support the valuation and existence of the balances. The VAT returns outstanding at 30 June 2008 had a receivable balance of R26.1 million. There is thus an unreconciled difference of R6.7 million.
27. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness, existence and valuation of the VAT debtor of R19.4 million.
28. Input VAT that was claimed from SARS on invalid VAT invoices in terms of section 20 of the Value-added Tax Act, 1991 (Act No. 89 of 1991) amounted to R2 million.

## **Cash and cash equivalents**

29. Outstanding cheques of R4.5 million, included in the reconciliation between bank statements and the cash book were found to have been cleared by the bank before 30 June 2008 and are thus invalid reconciling items. An adjustment of R6.4 million was made to bank balances and cash. No supporting documentation was submitted. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness, existence and valuation of the cash and bank balance of R19.8 million as disclosed in note 16 to the annual financial statements.

## **Capital commitments**

30. GAMAP 17.76(d) requires the disclosure of amounts committed for the acquisition of property, plant and equipment. Note 31 to the annual financial statements discloses capital commitments of R27.7 million. The municipality has not undertaken an adequate process of identifying and disclosing capital commitments both contracted for and not contracted for.
31. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness or valuation of capital commitments as disclosed in note 31 to the annual financial statements.

## **Irregular expenditure**

32. The municipality purchased seven farms, livestock and equipment in the Greater Kokstad Municipality, KwaZulu Natal for R40.9 million. Although the purpose of acquiring these farms appears to be in line with the objects of the municipality, due to the fact that the farms were purchased a month before the financial year-end, I was unable to verify if the farm was able to promote economic development in the O.R. Tambo District municipal area during the financial year under review.
33. In terms of section 28 of the DoRA, any unspent conditional grants should be returned to the National Revenue Fund, unless the accounting officer can prove to the satisfaction of the National Treasury that the unspent allocation is committed to identifiable projects. VAT on expenditure funded from these grants should be paid from equitable share to prevent the underlying investment from being depleted or VAT refunds should be paid back into the investment when received. These VAT refunds have been used to finance operating and capital expenditure, including the

purchase of the farms described above which is not in terms of the conditions of the grants. The municipality failed to obtain permission from the National Treasury to spend these funds. In terms of section 44(2) of the DoRA, spending of an allocation that is in contravention of this Act is considered to be irregular.

34. In terms of regulation 12 of the Supply Chain Management Regulations, a competitive bidding process should be conducted for procurement above a transaction value of R200 000. Payments of R0.6 million were made that were split into several payments under R200 000 in order to avoid the competitive bidding process. This expenditure is thus considered irregular.
35. In terms of paragraph 13.10.1 of the mayoral handbook issued by the South African Local Government Association (SALGA), the municipality must not supply linen, blankets, television sets, video recorders, decoders, wall decorations and ornaments to the mayoral residence. The municipality purchased R0.6 million worth of items as described above which were supplied to the mayoral residence. The accounting officer failed to implement appropriate policies and procedures to comply with the above regulation.
36. In terms of Government Notice R1224 published in Government Gazette No. 29447 of 1 December 2006, the upper limits of the total remuneration package of the executive mayor may include a motor vehicle allowance. In addition, the municipality may also make an official vehicle available provided it is used for official purposes. No procedures or policies have been adopted by the municipality to ensure that the mayoral vehicle is used only for official business or to identify private usage. It was not possible to determine the extent of the irregular expenditure incurred. The accounting officer failed to implement appropriate policies and procedures to comply with the above regulation.
37. The municipality provided mayoral residence at no cost to the mayor. Such a benefit does not fall within the framework of the Political Officers Bearers Act, 1998 (Act No. 20 of 1998) and would constitute a violation of section 167 of the MFMA. As a result, the market related rental of such a residence would constitute irregular expenditure. The cost of such housing was not recovered from the mayor, and the full extent of the irregular expenditure could not be determined. The accounting officer failed to implement appropriate policies and procedures to comply with the above regulation.
38. In terms of section 112 of the MFMA, the supply chain management policy of the municipality must comply with the Supply Chain Management Regulations (the prescribed regulatory framework). Payments of R0.6 million were made without the support of three quotations as required by the Supply Chain Management Regulations. Payments of R0.9 million were made without the support of orders, requisitions or contracts as required by the Supply Chain Management Regulations. These constitute irregular expenditure as the MFMA has not been complied with.
39. In terms of section 11(1) of the MFMA, only the municipal manager, chief financial officer or another delegated official may authorise the withdrawal of municipal funds from the municipality's bank accounts. The executive mayor was issued a municipal credit card in a previous financial year in order to enable her to effectively utilise the mayoral budget. During the year under review transactions with a value of R22 488 were recorded on this card. Since the credit card account is a municipal bank account, this expenditure constitutes irregular expenditure as the MFMA has not been complied with.



40. The municipality has omitted disclosure of irregular expenditure of at least R45.6 million which was incurred during the financial year. This is contrary to section 125(2)(d) of the MFMA, which requires disclosure of irregular expenditure in the annual financial statements.

#### **Fruitless and wasteful expenditure**

41. Three months of salary payments of R4 655 were made to an employee after her retirement. This constitutes fruitless and wasteful expenditure.
42. Section 11(1) of the MFMA prescribes the purposes for which expenditure may be incurred by the municipality. Private telephone calls by employees and officials are not included in such allowed expenditure. No system was in place to monitor and recover the cost of private telephone calls made by employees. Therefore it was not possible to determine the extent of this fruitless and wasteful expenditure.
43. The municipality has omitted disclosure of fruitless and wasteful expenditure described above which was incurred during the financial year. This is contrary to section 125(2)(d) of the MFMA, which requires disclosure of fruitless and wasteful expenditure in the annual financial statements.

#### **Related parties**

44. The municipality has not documented and implemented adequate procedures to identify related parties, as well as any transactions and balances with such related parties. Consequently it was not possible to obtain sufficient appropriate audit evidence to support the completeness and accuracy of related party disclosure.
45. As a result of the above, it was not possible to determine whether the information contained in the register of interests in contracts or the related party disclosure in the financial statements was complete and accurate.

#### **Councillors' arrear consumer accounts**

46. In terms of section 124(1)(b) of the MFMA, the notes to the annual financial statements of a municipality must include particulars of any arrears owed by individual councillors to the municipality for services and which at any time during the relevant financial year were outstanding for more than 90 days, including the names of those councillors. Councillors' arrear consumer accounts are not disclosed in the annual financial statements. Therefore it was not possible to verify the completeness and accuracy of the disclosure of councillors' arrear consumer accounts.

#### **Disclaimer of opinion**

47. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the O.R. Tambo District Municipality. Accordingly, I do not express an opinion on the financial statements.



## EMPHASIS OF MATTER

I draw attention to the following matters:

### Significant uncertainties

48. With reference to note 32 to the financial statements, the municipality is the defendant in various law-suits. The municipality is defending the claims. The ultimate outcome of the matters cannot presently be determined, and no provision for any liability that may result has been made in the financial statements.

### Restatement of corresponding figures

49. As disclosed in note 24 to the financial statements, the corresponding figures for 30 June 2007 have been restated as a result of errors discovered during 30 June 2008 in the financial statements of the O.R. Tambo District Municipality at, and for the

## OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

### Internal control

50. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The paragraphs below depict the root causes of the matters indicated, as they relate to the five components of internal control.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
<b>Basis for disclaimer of opinion</b>					
Revenue – service charges			X		X
Government grant and subsidies			X		X
Expenditure			X		X
Funds and reserves	X				
Provisions			X		X
Property, plant and equipment	X		X		X
Biological assets			X		X
Water inventory			X		X
Consumer			X		X

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
debtors					
VAT			X		X
Cash and cash equivalents			X		X
Capital commitments			X		X
Irregular expenditure			X		X
Fruitless and wasteful expenditure	X				
Related parties		X			
Councillors' arrear consumer accounts			X		X
<p><u>Control environment</u>: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.</p> <p><u>Risk assessment</u>: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.</p> <p><u>Control activities</u>: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.</p> <p><u>Information and communication</u>: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.</p> <p><u>Monitoring</u>: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.</p>					

### Non-compliance with the Municipal Finance Management Act

51. Section 89(a): The municipality did not determine the upper limits of the remuneration of the chief executive officer and senior managers of the municipal entity under control of the municipality. Furthermore, the municipality did not report to the council on staff remuneration matters according to prescribed categories.
52. Section 166: The municipality did not have an operating audit committee during the financial year.
53. Section 131(1): The municipality has not fully addressed issues raised in the prior year by the Auditor-General as a result of delays in tabling the audit and management reports with council. This is due to the late finalisation of the prior year audit report.

54. Section 65(2)(e): Invoices to the value of R4.3 million were not paid within thirty days.

#### **Fraud risk**

55. There is no approved fraud prevention plan at the municipality. This increases the risk of fraud and error within all major business cycles.

#### **Performance Management System**

56. Sections 39 and 40 of the Municipal Systems Act, 2000 (Act No.32 of 2000) require the development of a Performance Management System and the establishment of mechanisms to monitor and review the Performance Management System. There is insufficient evidence that the council complied with these statutory requirements during the year under review.

#### **Matters of governance**

57. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

<b>Matter of governance</b>	<b>Yes</b>	<b>No</b>
<b>Audit committee</b>		
• The municipality had an audit committee in operation throughout the financial year.		X
• The audit committee operates in accordance with approved, written terms of reference.		X
• The audit committee substantially fulfilled its responsibilities for the year, as set out in Section 166(2) of the MFMA.		X
<b>Internal audit</b>		
• The municipality had an internal audit function in operation throughout the financial year.	X	
• The internal audit function operates in terms of an approved internal audit plan.	X	
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in Section 165(2) of the MFMA.	X	
<b>Other matters of governance</b>		
• The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.	X	
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		X
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		X
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.	X	
• The prior year's external audit recommendations have been substantially implemented.		X

Matter of governance	Yes	No
<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b>		
<ul style="list-style-type: none"> <li>The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the provincial treasury before 30 October 2007.</li> </ul>		X
<ul style="list-style-type: none"> <li>The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.</li> </ul>		X
<ul style="list-style-type: none"> <li>The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.</li> </ul>		X

## OTHER REPORTING RESPONSIBILITIES

### Reporting on performance information

58. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

### Responsibility of the Auditor-General

59. I conducted my engagement in accordance with section 13 of the Public Audit Act, 2004 (Act No. 25 of 2004) read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

60. In terms of the foregoing, my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The audit procedures selected depend on the auditor's judgment.

61. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

### Audit findings (Performance information)

62. I was not able to complete an evaluation of the quality of the reported performance information since the information was not received.

## APPRECIATION

63. The assistance rendered by the staff of the O.R. Tambo District Municipality during the audit is sincerely appreciated.

*Auditor-General*

EAST LONDON  
30 November 2008



AUDITOR-GENERAL